

§ 1.535-1

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§ 1.535-1 Definition.

(a) The accumulated earnings tax is imposed by section 531 on the accumulated taxable income. Accumulated taxable income is the taxable income of the corporation with the adjustments prescribed by section 535(b) and § 1.535-2, minus the sum of the dividends paid deduction and the accumulated earnings credit. See section 561 and the regulations thereunder, relating to the definition of the deduction for dividends paid, and section 535(c) and § 1.535-3, relating to the accumulated earnings credit.

(b) In the case of a foreign corporation, whether resident or nonresident, which files or causes to be filed a return, the accumulated taxable income shall be the taxable income from sources within the United States with the adjustments prescribed by section 535(b) and § 1.535-2 minus the sum of the dividends paid deduction and the accumulated earnings credit. In the case of a foreign corporation which files no return, the accumulated taxable income shall be the gross income from sources within the United States without allowance of any deductions (including the accumulated earnings credit).

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 7244, 37 FR 28897, Dec. 30, 1972]

§ 1.535-2 Adjustments to taxable income.

(a) *Taxes*—(1) *United States taxes*. In computing accumulated taxable income for any taxable year, there shall be allowed as a deduction the amount by which Federal income and excess profits taxes accrued during the taxable year exceed the credit provided by section 33 (relating to taxes of foreign countries and possessions of the United States), except that no deduction shall be allowed for (i) the accumulated earnings tax imposed by section 531 (or a corresponding section of a prior law), (ii) the personal holding company tax imposed by section 541 (or a corresponding section of a prior law), and (iii) the excess profits tax imposed by subchapter E, chapter 2 of the Internal Revenue Code of 1939, for taxable years beginning after December 31, 1940. The deduction is for taxes accrued during the taxable year, regardless of whether

the corporation uses an accrual method of accounting, the cash receipts and disbursements method, or any other allowable method of accounting. In computing the amount of taxes accrued, an unpaid tax which is being contested is not considered accrued until the contest is resolved.

(2) *Taxes of foreign countries and United States possessions*. In determining accumulated taxable income for any taxable year, if the taxpayer chooses the benefits of section 901 for such taxable year, a deduction shall be allowed for:

(i) The income, war profits, and excess profits taxes imposed by foreign countries or possessions of the United States and accrued during such taxable year, and

(ii) In the case of a domestic corporation, the foreign income taxes deemed to be paid for such taxable year under section 902(a) in accordance with §§ 1.902-1 and 1.902-2 or section 960(a)(1) in accordance with § 1.960-7.

In no event shall the amount under subdivision (ii) of this subparagraph exceed the amount includible in gross income with respect to such taxes under section 78 and § 1.78-1. The credit for such taxes provided by section 901 shall not be allowed against the accumulated earnings tax imposed by section 531. See section 901(a).

(b) *Charitable contributions*. Section 535(b)(2) provides that, in computing the accumulated taxable income of a corporation, the deduction for charitable contributions shall be computed without regard to section 170(b)(2). Thus, the amount of charitable contributions made during the taxable year not allowable as a deduction under section 170 by reason of the limitations imposed by section 170(b)(2) shall be allowed as a deduction in computing accumulated taxable income for the taxable year. However, any excess of the amount of the charitable contributions made in a prior taxable year over the amount allowed as a deduction under section 170 for such year shall not be allowed as a deduction from taxable income in computing accumulated taxable income for the taxable year.

(c) *Special deductions disallowed.* Sections 241 through 248 provide for the allowance of special deductions for such items as partially tax-exempt interest, certain dividends received, dividends paid on certain preferred stock of public utilities, and organizational expenses. Such special deductions, except the deduction provided by section 248 (relating to organizational expenses) shall be disallowed in computing accumulated taxable income.

(d) *Net operating loss.* The net operating loss deduction provided in section 172 is not allowed for purposes of computing accumulated taxable income.

(e) *Capital losses.* (1) Losses from sales or exchanges of capital assets during the taxable year, which are disallowed as deductions under section 1211(a) in computing taxable income, shall be allowed as deductions in computing accumulated taxable income.

(2) The computation of the capital losses allowable as a deduction in computing accumulated taxable income may be illustrated by the following example:

Example. X Corporation has capital losses of \$30,000 which are disallowed under section 1211(a) for the taxable year ended December 31, 1956. This amount represents a loss of \$25,000 from the sale or exchange of capital assets during the taxable year ended December 31, 1956, plus a \$5,000 capital loss carryover resulting from the sale or exchange of capital assets during the taxable year ended December 31, 1955. In computing accumulated taxable income for the taxable year ended December 31, 1956, only the loss of \$25,000 arising from the sale or exchange of capital assets during that taxable year will be allowed as a deduction.

(f) *Long-term capital gains.* (1) There is allowed as a deduction in computing accumulated taxable income, the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year (determined without regard to the capital loss carryover provided in section 1212) minus the taxes attributable to such excess as provided by section 535(b)(6). The tax attributable to such excess is the difference between:

(i) The taxes (except the accumulated earnings tax) imposed by subtitle A of the Code for such year, and

(ii) The taxes (except the accumulated earnings tax) imposed by subtitle A computed for such year as if taxable income were reduced by the excess of the net long-term capital gain over net short-term capital loss (including the capital loss carryover to such year).

Where the tax (except the accumulated earnings tax) imposed by subtitle A includes an amount computed under section 1201(a)(2), the tax attributable to such excess is such amount computed under section 1201(a)(2).

(2) The application of the rule in subparagraph (1) of this paragraph may be illustrated by the following example:

Example. Assume that D Corporation, for the taxable year ended December 31, 1956, has taxable income of \$103,000 of which \$8,000 is the excess of net long-term capital gain of \$12,000 over a net short-term capital loss of \$9,000. The \$9,000 net short-term capital loss includes a capital loss carryover of \$5,000. The amount allowable as a deduction under section 535(b)(6) and subparagraph (1) of this paragraph is \$7,250, computed as follows: Net long-term capital gain less net short-term capital loss (computed without regard to the capital loss carryover) is \$8,000 (that is, \$12,000 net long-term capital gain less \$4,000 net short-term capital loss computed without regard to the capital loss carryover of \$5,000). The tax attributable to the excess of net long-term capital gain over net short-term capital loss (computed by taking the capital loss carryover into account) is \$750, that is, 25 percent of such excess of \$3,000, computed under section 1201(a)(2). The difference of \$7,250 (\$8,000 less \$750) is the amount allowable as a deduction in computing accumulated taxable income.

(3) Section 631(c) (relating to gain or loss in the case of disposal of coal or domestic iron ore) shall have no application in determining the amount of the deduction allowable under section 535(b)(6).

(g) *Capital loss carrybacks and carryovers.* Capital losses carried to a taxable year under section 1212(a) shall have no application for purposes of computing accumulated taxable income for such year.

(h) *Bank affiliates.* There is allowed the deduction provided by section 601

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in the case of bank affiliates (as defined in section 2 of the Banking Act of 1933; 12 U. S. C. 221a(c)).

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§ 1.535-3 Accumulated earnings credit.

(a) *In general.* As provided in section 535(a) and § 1.535-1, the accumulated earnings credit, provided by section 535(c), reduces taxable income in computing accumulated taxable income. In the case of a corporation, not a mere holding or investment company, the accumulated earnings credit is determined as provided in paragraph (b) of this section and, in the case of a holding or investment company, as provided in paragraph (c) of this section.

(b) *Corporation which is not a mere holding or investment company—(1) General rule.* (i) In the case of a corporation, not a mere holding or investment company, the accumulated earnings credit is the amount equal to such part of the earnings and profits of the taxable year which is retained for the reasonable needs of the business, minus the deduction allowed by section 535(b)(6) (see paragraph (f) of § 1.535-2, relating to the deduction for long-term capital gains). In no event shall the accumulated earnings credit be less than the minimum credit provided for in section 535(c)(2) and subparagraph (2) of this paragraph. The amount of the earnings and profits for the taxable year retained is the amount by which the earnings and profits for the taxable year exceed the dividends paid deduction for such taxable year. See section 561 and §§ 1.561-1 and 1.561-2, relating to the deduction for dividends paid.

(ii) In determining whether any amount of the earnings and profits of the taxable year has been retained for the reasonable needs of the business, the accumulated earnings and profits of prior years will be taken into consideration. Thus, for example, if such accumulated earnings and profits of prior years are sufficient for the reasonable needs of the business, then any earnings and profits of the current taxable year which are retained will not be considered to be retained for the rea-

sonable needs of the business. See section 537 and §§ 1.537-1 and 1.537-2.

(2) *Minimum credit.* Section 535(c)(2) provides for the allowance of a minimum accumulated earnings credit in the case of a corporation which is not a mere holding or investment company. Except as otherwise provided in section 243(b)(3) and § 1.243-5 (relating to effect of 100-percent dividends received deduction under section 243(b)) and sections 1561, 1562, and 1564 (relating to limitations on certain tax benefits in the case of certain controlled corporations), in the case of such a corporation, this minimum credit shall in no case be less than the amount by which \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975) exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year. See paragraph (d) of this section for the effect of dividends paid after the close of the taxable year in determining accumulated earnings and profits at the close of the preceding taxable year. In determining the amount of the minimum credit allowable under section 535(c)(2), the needs of the business are not taken into consideration. If the taxpayer has accumulated earnings and profits at the close of the preceding taxable year equal to or in excess of \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975), the credit, if any, is determined without regard to section 535(c)(2). It is not intended that the provision for the minimum credit shall in any way create an inference that an accumulation in excess of \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975) is unreasonable. The reasonable needs of the business may require the accumulation of more or less than \$150,000 (\$100,000 in the case of taxable years beginning before January 1, 1975), depending upon the circumstances in the case, but such needs shall not be taken into consideration to any extent in cases where the minimum accumulated earnings credit is applicable. For a discussion of the reasonable needs of the business, see section 537 and §§ 1.537-1, 1.537-2, and 1.537-3.

(3) *Illustrations of accumulated earnings credit.* The computation of the accumulated earnings credit provided by